STATEMENT ON

NATURE AND EXTENT OF ABUSE AND MISCONDUCT
IN COMMERCIAL BANKS

PRESENTED TO

SUBCOMMITTEE ON COMMERCE, CONSUMER, AND MONETARY AFFAIRS
COMMITTEE ON GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

BY

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9:30 a.m.
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Room 2247, Rayburn House Office Building

Good morning, Mr. Chairman and members of the Subcommittee. I am pleased to be here today to express the views of the Federal Deposit Insurance Corporation on this very important subject -- fraud and abuse of position in the nation's financial institutions. The FDIC staff has prepared detailed answers to the questions contained in your letter of invitation. The staff's report is attached to this statement and I request that it be included in the record.

FRAUD AND INSIDER ABUSE

The number of insured banks that have been victimized by fraud and insider abuse has increased dramatically since 1982 resulting in greater costs to the banking industry and to the FDIC insurance fund. However, while bank fraud is a major concern and area of focus for the FDIC, bank fraud is not at such a level that the safety of the banking system is imperiled.

Bank failures are occurring at a post-depression record rate. We expect about 200 failures this year. As of today, 160 banks already have failed. We had expected a break in this upward trend next year. However, we are now reassessing our projections in light of the recent correction in the stock market and its potential adverse effects on the economy.

We are seeing evidence of insider abuse and fraud in as many as one third of the banks that fail. The "autopsies" the FDIC conducts in the wake of bank failures also show that outright criminal activity is a factor in nearly 15 percent of recent failures.

From January 1985 through June 1987, 98 of the 354 banks that failed were cited by examiners as having at least some element of fraud or insider abuse. These 98 banks had assets of $2.70 billion and the cost to the FDIC of these failures is estimated to be nearly $676 million.

While fraud losses in failed banks are still significant, our experience since 1985 suggests a somewhat lessened impact of fraud and abuse compared to the period studied by your Subcommittee leading to its 1984 report. Our current experience is more in line with the historical trend and is consistent with the impact of fraud and abuse reported in an FDIC study of bank failures between 1960 and 1974.

The FDIC has taken several major steps to improve our supervisory response to fraud and abuse in the banks we supervise. Since the Subcommittee's 1984 report, we have:

- Completely revised the criminal reporting system to require banks, by regulation, to report apparent crimes to U.S. attorneys, federal investigators and the FDIC on a standard referral form.
- Established a network of personal contacts to improve communication and cooperation with law enforcement agencies.
- Published a list of time tested "Red Flags" and other warning signs of fraud and abuse to be used as an aid by examiners and auditors.
- Designated some 60 senior examiners as bank fraud specialists to be given specialized training in bank fraud and insider abuse.

- Improved and greatly increased the training opportunities for examiners, investigators, liquidators and prosecutors by the addition of an interagency school on white collar crime, joint FBI/examiner training sessions and expanded treatment in the FDIC schools.

- Designated special review examiners and regional counsel in regional offices to prepare criminal referrals, coordinate investigative assistance and testimony and to advise banks and other examiners on criminal laws and criminal referral requirements.

- Provided liquidators and other employees of our Division of Liquidation with special training and refresher courses on bank fraud and abuse and investigation techniques.

- Installed a computer system to collect information about criminal referrals for tracking and analytical purposes and to identify subjects of criminal referrals by name recognition.

- Decentralized and streamlined our civil enforcement process. Delegations of authority to Regional Directors permits expeditious and efficient administrative actions while maintaining Washington control over issues that are controversial or raise policy questions.

I would like to repeat that current levels of bank fraud, while serious and costly, do not jeopardize the banking system. At the same time, the rising level of failures, and the increased cost of insider abuse and fraudulent behavior, raise issues that we need to explore.

I commend you, Mr. Chairman, for challenging us with some very important questions:

- How do we improve the audit capabilities of banks to prevent and detect fraud and abuse?

- How do we insure that all bank directors adhere to high standards of conduct?

- How do we improve intergovernmental coordination and information sharing to assure vigorous investigations and prosecution of criminal conduct?

INDEPENDENT AUDITS OF BANKS

First, I would like to comment on our proposal to require independent audits of banks. We estimate that around two thirds of the banks in this country already get opinion audits. As would be expected, larger banking organizations are more likely to have independent audits. But even so, about half the banks under $50 million in assets get outside audits.

Nevertheless, more small banks would be impacted by an audit requirement than large banks. And, the smaller the bank, the more difficult a cost effective audit becomes.

We have reviewed about 250 of the banks that failed in 1986 and during the first nine months of 1987. We found that only 40 percent of those banks had an outside audit written during the two years prior to failure. In other words, it appears that deeply troubled banks are much less likely to have an outside audit. We also found that about 40 percent of the failed banks, with opinion audits, had received qualified opinions from their auditors. Clearly, these audits would have provided information that could have been used by bank supervisors.

We appear to be near agreement with the other bank regulators on requiring annual audits for all banks over a certain asset size threshold. We now are considering a threshold in the range of $100 to $150 million in assets.

Our current proposal would require each state nonmember bank above a threshold size to:

- Engage an independent public accountant to perform an opinion audit each calendar year.

- Have the bank's board of directors perform a timely review of the auditors report and the management letter, with such review noted on the board of directors' minutes. The bank would be required to send copies of these reports to the FDIC.

- Require the bank to notify the FDIC when the bank changes its independent auditor.

We also are considering your idea, Mr. Chairman, of requiring banks to show their auditors the bank's latest examination report.

We also are reviewing the possibility of developing something less than an audit for smaller banks (those under the yet-to-be established threshold). In other words, we are considering requiring something in the nature of a "checkup" rather than a "complete physical" -- something that smaller banks would find affordable and that focuses on potential problem areas such as internal controls and insider abuse. We have challenged the AICPA to help us develop a program specially designed for a cost effective examination of small banks.

We believe outside audits can benefit the supervision process, as well as shoring up the internal operations of insured banks and aiding in fraud prevention and detection.

DIRECTORS' RESPONSIBILITY AND CODES OF CONDUCT

We also believe that the supervisory process benefits greatly if bank directors adhere to and are held to high standards of conduct and responsibility. While it is true that the great majority of bank directors already meet these high standards, we nevertheless felt it necessary to emphasize this point to all present and prospective bank directors.

The FDIC, along with other agencies, just released final guidelines under the Bank Bribery Statute encouraging banks to establish and maintain effective codes of conduct. The FDIC also has just issued guidelines advising bank directors in "plain English" of their responsibilities to oversee the conduct of the bank's business, to keep informed and exercise independent judgment. The guidelines advocate the avoidance of all preferential transactions involving insiders and related interests and advise directors of their critical role in keeping the banking system safe and sound.

INTERAGENCY TEAMWORK

In December of 1984, the Attorney General established an interagency group to deal with fraud and abuse. This "teamwork" approach has been very successful in coordinating efforts at the headquarters level. Real progress also is being made at the local level, where information in one form or another is critical to the success of specific investigations and prosecutions.

We have been pleased with the commitment demonstrated by the Justice Department's Criminal Division and believe that this commitment is evident in the accomplishments of the Working Group. We also are pleased with the efforts of many U.S. Attorneys to carry this commitment to their local districts. Unquestionably, local forums such as the one established in Chicago represent an effective solution to problems relating to coordination and cooperation. We would like to see more of these forums established, particularly in districts having a heavy load of bank fraud cases.

AGENCIES' JOINT ENFORCEMENT PROPOSAL

A working group of the financial institution agencies recently completed a proposal to amend the enforcement statutes to improve the agencies' ability to address instances of insider abuse, misconduct and fraud at our nation's depository institutions. The amendments clarify the enforcement powers of the agencies in several respects, codify current administrative interpretations and address certain anomalies created by a recent U.S. Circuit Court of Appeals decision.

Several of the amendments contained in that proposal amend the Right to Financial Privacy Act (RFPA). Currently, the flow of information that is critical to successful prosecutions and effective bank supervision is unduly constrained by the RFPA. Probably the most adverse impact of the RFPA on our cooperative efforts to deal with fraud and abuse is the psychological impediment the Act exerts on the interactions between examiners and law enforcement agents. We will never know how many cases have been jeopardized by this chilling effect. However, we do not doubt that the public interest has been harmed by RFPA constraints on intergovernmental exchanges of information.

One case is particularly illustrative. During a criminal investigation of a failed bank, the FBI learned of the whereabouts of millions of dollars. Because of legal restrictions, however, this crucial information could not be passed on to the FDIC. Thus, the FDIC lost the opportunity to restore millions of dollars to the FDIC insurance fund. Amending the RFPA as recommended by the Bank Fraud Working Group and this legislative proposal would enhance greatly our cooperative efforts with Justice in ferreting out and prosecuting fraud and abuse.

CONCLUSION

In conclusion, bank fraud and abuse is costly and serious but does not imperil the banking system. We cannot let up on ferreting out and penalizing fraud and abuse until a strong deterrent to such activities is firmly established.

Thank your Mr. Chairman.

STAFF RESPONSES TO QUESTIONS IN CHAIRMAN BARNARD'S
NOVEMBER 6, 1987 LETTER

This staff report is intended to supplement Chairman Seidman's testimony before the Subcommittee on November 19, 1987. Question A1 is addressed in the Chairman's testimony and in our earlier submission.

NATURE AND EXTENT OF ABUSE AND MISCONDUCT IN COMMERCIAL BANKS

A.2.Question:

Based on the agency's analysis of those criminal referrals included in the Criminal Division's Significant Referral Tracking System, please identify (a) any trends or patterns of fraud or other misconduct, and (b) the types of institutions most affected (such as by categories of asset sizes or geographical distributions).

A.2.Answer:

On a geographic basis, criminal referrals pertaining to banks under our supervision tend to be concentrated in the larger states and in states suffering economic problems. Texas, Illinois and California head the list followed by Louisiana, Florida and Georgia. Tennessee and Oklahoma are also in the top ten. As in past years, criminal referrals continue to cite embezzlement, false entries and misapplication of funds as the main violations. However, more and more cases are being reported under the new Bank Fraud Statute. These violations usually involve outsiders rather than insiders. The trend to more violations by outsiders in the last year and one-half diverges from the historical norm. Historically, the proportion has been about 20 percent outsiders to 80 percent insiders. We have seen that proportion change to 30 percent outsiders to 70 percent insiders for "significant" referrals and to almost 40/60 percent when all referrals over $10,000 are considered. This trend probably reflects the vulnerable state in which many banks find themselves as they try to survive severe economic conditions and increased competitive pressures. Faced with possible insolvency and meager prospects for recapitalizing, bank mangers and owners stretch for high yields and sometimes get caught by fraudsters and con artists.

During 1985, 1986 and through the first half of 1987, ninety-eight (or 28%) of the 354 banks that failed were cited by examiners as having at least some element of fraud or insider abuse. The 98 banks had assets of $2.7 billion and the cost to the FDIC is estimated at $676 million. These losses, however, represent the estimate of <u>total</u> losses, not just those caused by fraud and abuse and should not be viewed as an accurate gauge of fraud and abuse losses. While still significant, our experience since 1985 reflects a somewhat lessened impact of fraud and abuse compared to the period studied by the Subcommittee leading to the 1984 report. During that period we estimated that about 45 percent of bank failures involved fraud and abuse. Our current experience is more in line with the historical trend and is consistent with the impact of fraud and abuse reported in an FDIC study of bank failures between 1960 and 1974 which cited defalcation, embezzlement or manipulation in 31.3 percent of the failures.

A.3.Question:

Are there certain kinds of misconduct becoming more prevalent and are certain schemes being utilized more frequently, particularly in problem or subsequently insolvent institutions (often where there is no formal referral but where there are FDIC lawsuits or criminal investigations)? What kinds of misconduct are more difficult for examiners to detect in solvent institutions?

A.3.Answer:

As in past years, criminal referrals continue to cite embezzlement, false entries and misapplication of funds as the main violations. However, as stated in our answer to Question A.2., we are seeing more fraudulent attempts to obtain funds from banks by outsiders. Some of these attempts have led to bank failures and reflect deliberate criminal activity. More illegal takeovers of small banks have occurred or have been attempted in recent years. In some of these situations, the Change in Bank Control Act requirements have been completely ignored. In others, Change in Control Notices were filed, but control was acquired before the FDIC could act to disapprove the transaction. We successfully thwarted a number of these attempts through aggressive supervisory efforts and with the assistance of local FBI agents. Appraisal fraud is apparently more prevalent than in the past. Currently, a real estate appraisal fraud in the Southwest has impacted fifteen state nonmember banks, two of which have recently failed, though not as a direct result of fraudulent real estate loans.

Virtually any kind of theft or fraud can be concealed from an examiner for some period of time -- until it becomes so large it can no longer be covered-up. Examiners are present in a bank for a very small amount of time. That is why banks themselves bear the primary responsibility for preventing fraud and abuse and why we are encouraging the accounting profession to assume a greater responsibility for fraud detection when conducting outside audits.

<u>A.4.Question</u>:

4. The FDIC advised the subcommittee that "banks can protect themselves from undue risk [when purchasing loan participations] by employing fundamental credit analysis and instituting sound documentation controls." The Home Loan Bank Board has attempted to address the problem of loan participations involving fraudulent or unsafe loans by requiring that the purchasing institution obtain copies of certain relevant and specific underwriting documents. Has the FDIC implemented such a regulation? If not, why not?

<u>A.4.Answer</u>:

We do not believe that loan participations should be singled out from other types of lending instruments, all of which can be subject to various types of fraud or other misconduct limited only, in many respects, by the imagination of the individual or individuals involved in this activity. Traditionally, the FDIC has not regulated the lending practices of state nonmember banks although lending practices are supervised closely. We do not see a serious, widespread problem involving loan participations which cannot be corrected by normal supervisory means. Furthermore, while the requirement of having the purchasing institution obtain copies of certain relevant and specific underwriting documents is a sound banking practice, it does not address all of the potential problems related to loan participations. Banks would still need to establish sound internal controls and lending constraints to avoid trouble.

Loan participations are closely scrutinized by FDIC examiners. Examiners are instructed to determine the nature and adequacy of the participation arrangement as well as analyze the credit quality of the participation to the same extent as if it were a direct obligation of the bank. In this regard, all relevant loan documentation and credit information should be obtained prior to any commitment being made to purchase the asset. Failure to follow these minimum procedures would be considered an unsatisfactory banking practice. To assist our examiners with early detection of apparent bank fraud and insider abuse, a list of early warning signs ("Red Flags") was developed earlier this year for a number of subject areas, including loan participations. By following this guide, the examiner not only will be reviewing loan participations for compliance with sound policies and operating procedures but also will be alert to the possibility of abuse and misconduct.

MANPOWER RESOURCES AND FREQUENCY OF EXAMINATIONS

B.1.Question: Manpower Resources and Difficulties:

a. Please describe examiner manpower levels for FY 1985, 1986, and 1987, indicating (i) net increases in numbers of examiners, (ii) numbers of examiners which have left the agency, and (iii) the number which have been hired. How many examiners is the agency system planning to hire in 1988? Have salaries been increased? b. In which regions or states has the agency made the greatest percentage increases in the number of examiners?

B.1.Answer:

(a) Year End	FDIC Field Examiner Level	(i) Net Increase in Examiners	(ii) Number Left FDIC	(iii) Number Hired
1985	1,547	158	144	362
1986	1,726	179	152	336
September 30, 1987	1,919	193	153	357
1987 (Estimate)	2,000	274	204	489
1988 (Estimate)	2,034	34	220	254

The only salary increases have been periodic cost-of-living adjustments accorded to Federal employees.

(b) The FDIC Chicago Region has had the greatest percentage increase in field examiners so far this year. The number of field examiners increased by 24.04 percent from 183 on January 1, 1987 to 227 as of September 30, 1987. The Dallas Region was the second highest with 20.50 percent.

B.2.Question:

(a) What is the actual frequency of examinations at present for (i) nonproblem institutions and (ii) problem institutions, and what was it in the recent past? Do you have any data showing frequency of examinations for failed State nonmember banks? If so, please provide. (b) What examination frequency would you prefer, and how many examiners and how much time would it require to reach that frequency? (c) Has the agency done any studies or analyses to determine whether there is a correlation between either frequency of examinations or time elapsed since the last examination and the existence of insider abuse or misconduct?

B.2.Answer:

(a) Average intervals between regular FDIC examinations for State nonmember banks vary dramatically by region based on such factors as economic conditions, regional banking structures, size and number of problem institutions, quality of State examination programs and staff availability. Our policy calls for examinations of 3-, 4- and 5-rated institutions every 12 months with 1- and 2-rated institutions examined as often as necessary but with a maximum interval of 36 months between examinations. The policy permits the Regional Director to extend the intervals for 1- and 2-rated institutions up to 60 months for good cause. At this time, our examination aging schedule shows that 33 percent of the 4- and 5-rated institutions and 40 percent of the 3-rated institutions have not been examined within 12 months, while 25 percent of the 1- and 2-rated institutions have not been examined within 3 years.

The FDIC's regular examination program is supplemented with a variety of other examination tools that are not included in the above statistics. These tools include onsite visitations, offsite monitoring and analysis, and review of interim State examinations. Based on the results of any one or a combination of these tools, together with other relevant factors such as staff availability, the FDIC Regional Director has the authority to set Regional examination priorities.

We do not maintain statistics on the frequency of examinations for failed State nonmember banks. However, the relationship between failed state nonmember banks and examination intervals could be developed from information in our supervisory files. The vast majority of the failed institutions would have been rated 3, 4 or 5 which would place them in our most stringent examination frequency cycle.

(b) We would like to examine all 3-, 4-, and 5-rated institutions at least annually and 1- and 2-rated institutions once every 24 months, unless other factors, such as economic conditions and offsite surveillance, indicate that a longer interval can be allowed safely. In order to achieve such a level of examinations, we estimate that we would need approximately 2,300 experienced examiners. It would take about 2 years to increase our staff from the 2,000 estimated for year-end 1987 to the 2,300 level, and an additional 3 years for those new hires to become experienced.

(c) The FDIC has not studied the correlation between examination frequency and the existence of insider abuse.

<u>B.3.Question</u>:

From which state banking authorities do FDIC regional offices routinely not enter examination report data in its own database, nor recognize such examination efforts, concerning state-chartered banks. (Please list.) Do state-chartered banks in these states have a higher incidence of insider abuse, criminal misconduct, or unsafe or unsound practices than banks in those states whose state examinations are accepted and recognized?

<u>B.3.Answer</u>:

State examination reports received by the FDIC are reviewed at the Regional Office level and become part of our examination records. Because of the wide variance in the size and abilities of the State banking department programs, the FDIC, over the years, has entered into a variety of formal and informal examination arrangements designed to best utilize the resources available. For example, the FDIC may conduct joint examinations, concurrent examinations, independent examinations or any combination of such with the State department depending on the resources available and the circumstances involved. While it is clear that some State banking departments are better than others and consequently some State examination reports are more reliable than others, the FDIC has not identified specific criteria or developed accurate methods to evaluate State departments.

The decision to enter or not enter State examination results into our mainframe database is currently left to the discretion of the Regional Director and is not necessarily based on the competence of the State banking department. Some of the other factors considered in that decision include the scope of the State examination, date of the examination, date received by the FDIC, date of next scheduled FDIC examination, and the workload and priorities of the Regional Office staff.

The FDIC has not studied the correlation between a higher incidence of insider abuse, criminal misconduct or unsafe and unsound practices in banks and the strength of the state's banking department.

PROPOSALS TO IMPROVE AUDIT CAPABILITIES AND RELY ON BOARDS OF DIRECTORS TO PREVENT OR DETECT FRAUD OR OTHER MISCONDUCT

C.1.Question:

The FDIC has proposed requiring independent financial audits of all State nonmember banks it supervises. However, it advised the subcommittee that "for an audit requirement to be most effective, it should apply to all insured banks," not simply the banks for which it is the primary regulator. Hence, FDIC staff has been working with staff of the OCC and the FRB to gain their cooperation in developing a joint audit requirement applicable to all banks. (a) What has been the reaction of the OCC staff and the FRB staff to this proposal? (b) If the other agencies do not cooperate, does the FDIC have statutory authority to impose such a requirement on all Federally insured banks, as a condition of continued deposit insurance? (c) Turning to the FDIC's policy toward applicants for Federal deposit insurance (adopted 5/28/87), which states that the FDIC "expects" such audits, what actions will the FDIC take if such is not done?

C.1.Answer:

(a) The FDIC has been continuing its efforts to obtain interagency agreement on an independent audit requirement for banks through discussions with staff members from both the Office of the Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (Fed). Both the OCC and the Fed have been cooperative in this effort, and we believe we will be able to reach an interagency agreement.

(b) The FDIC believes that under its existing statutory authority it would be limited to imposing an audit requirement on insured state nonmember banks only.

(c) To date, no operating institution applying for deposit insurance has failed to satisfy our expectation that it have an annual audit. Since the Federal Home Loan Bank Board has an audit requirement for institutions under its supervision, it is not surprising that no operating FSLIC-insured institution applying for FDIC insurance coverage has encountered problems with this expectation.

C.2.Question:

The Federal Home Loan Bank Board requires the submission of audit reports by thrift institutions to the district bank supervisors within 15 days of the receipt of the audit report. However, all of the other Federal bank regulatory agencies, including your own, only require that examiners review the report during the next examination. In view of the frequency of agency examinations, would it not be useful to issue a similar agency requirement, notwithstanding the lack of an audit requirement, to promptly receive and review audit reports in order to detect problems early on and, as necessary, take prompt supervisory action?

C.2.Answer:

The FDIC has not wanted to discourage those banks that voluntarily have independent audits from continuing to do so by imposing more requirements on them than on unaudited institutions. Nevertheless, many banks routinely submit their audit reports and/or management letters to our regional offices. Since we are continuing to pursue the possibility of an audit regulation, we would plan to include in it a requirement that audit reports and management letters be filed promptly with the FDIC. As an interim step, the staff is also considering having FDIC examiners seek the commitment of an audited bank's management or board of directors to submit these letters promptly after the bank is audited. Should we determine not to proceed with an audit regulation, we may decide to require that reports from voluntary audits be filed with the FDIC.

C.3.Question:

None of the bank regulatory agencies requires (as opposed to allows) that examination reports be provided to independent auditors hired by financial institutions. In their responses to the subcommittee, all of the agencies (but the NCUA) expressed concerns that mandating disclosure of examination reports to independent auditors would compromise the ability to keep the reports confidential. I sent to the Federal Reserve Board my views on a proposed regulation which furthers this policy (see attached October 9, 1987, letter). Please respond to my concerns that troubled institutions or ones in which misconduct is occurring will not volunteer such examination reports and my belief that it is possible to place conditions on auditors who review such reports, such as only onsite reviews and written pledges of confidentiality, particularly in view of a certified public accountant's ethical duties to its client.

C.3.Answer:

While the FDIC has long opposed mandatory disclosure of examination reports to independent auditors hired by financial institutions because of our concern for the confidential nature of the report, the financial integrity of the bank, the legitimate privacy interests of any individual named in the report, and the independence of the supervisory agencies and their examinaticn process, we are considering a requirement that audited banks show the bank examination report to their independent auditor.

In our opinion, independent auditors should review the most recent supervisory examination report and, in their capacity as bank agents, they are allowed to review examination reports routinely without prior FDIC approval. If a situation developed whereby a bank refused to allow an independent auditor access to the examination report, the auditors probably would not give the bank an unqualified opinion. Moreover, the auditors still could obtain access to the report by making a written request to the FDIC outlining the specific records requested and the reasons for the request. Such a request would alert the FDIC to a potential problem at the bank.

PROPOSALS TO INCREASE RESPONSIBILITIES OF BOARDS OF DIRECTORS

C.4.Question:

a. The FDIC is working with all of the other bank regulators to develop a code of conduct for bank directors, to place more responsibility on them. What actual proposals are being considered? (Furnish a draft if one is available.) What proposals would the FDIC like to see implemented?

b. Does the FDIC require that management send to the board of directors copies of all informal and formal civil enforcement or supervisory actions? If not, why not? If so, how is compliance enforced?

c. Two agencies have suggested to the subcommittee that the responsibility to check into the background of employees, including officers, rests with management and boards of directors, not the bank regulatory agencies. Does the FDIC conduct a name check and provide information on an individual at the request of a financial institution hiring such person to determine the existence of prior civil enforcement orders, criminal referrals, or any other information maintained by the agency? If not, why not?

C.4.Answer:

a. The FDIC has worked with the other depository institution regulators, including the FHLBB, to develop a relatively short, plain English set of guidelines for financial institution directors. The guidelines essentially mirror existing law and sound banking practices but place no new responsibilities on financial institution directors. A copy of the guidelines is attached. The FDIC Board of Directors has approved the guidelines which are now being printed for distribution to banks and bank directors.

b. Copies of all formal enforcement actions issued by the FDIC are sent directly to the respondent bank's board of directors. In general, proposed Orders are discussed and negotiated with the board rather than with management and in all instances the final decisions regarding Section 8(b) enforcement actions must be acted upon by the board as a corporate body. Informal actions in the form of Memoranda of Understanding carry the signature of each bank director. Thus, since the FDIC deals directly with the board of directors with respect to formal and informal civil enforcement and supervisory actions, we do not see a need to require a bank's management to send the board copies of such actions. Compliance with enforcement actions is enforced through various means, including frequent visitations and examinations, the detailing of compliance with each point in an Order in visitation and examination reports, meetings with management and/or the board, follow-up correspondence between our Regional Office and the bank, off-site monitoring, etc.

c. The FDIC does not routinely conduct name checks on individuals at the request of financial institutions. Personal information contained in criminal referrals is covered by the Privacy Act of 1974, and the FDIC strictly adheres to its provisions. Should the circumstance arise where an inquiry is made by a bank regarding an individual who has been the subject of an FDIC enforcement action which has become final, such information would be appropriately disclosed. Should an individual who has been removed from one bank pursuant to section 8(e) of the Federal Deposit Insurance Act become employed by another insured institution, the FDIC would seek enforcement of its Order in accordance with the provisions of the Act.

INTERAGENCY COORDINATION AND CONSULTATION AMONG AND BETWEEN BANK REGULATORY AGENCIES AND LAW ENFORCEMENT AGENCIES

D.1, 2(a), 2(b).Questions:

Do you have any views on improvements to the structure and operations of the Interagency Bank Fraud Working Group. (To prevent repetition and save time, I would request that you not discuss the accomplishments of the interagency bank fraud working group, unless directly relevant in answering this question, as the Federal Reserve Board and the Criminal Division witnesses have been asked to provide this information.)

2. The subcommittee has uncovered problems due to a lack of coordination and communication between the Justice Department (including the FBI) and the bank regulatory agencies and fee counsel at local levels, with one notable exception, the Chicago area (and now perhaps California). At the subcommittee's June 13, 1987, hearing in Los Angeles, U.S. Attorney Bonner

testified, "It would be helpful to have the FBI periodically meet with examiners to discuss the types of bank frauds prevalent in a given district. Many frauds follow certain patterns. Experienced FBI agents and examiners could exchange information which would assist examiners in identifying the 'badges' of fraud." (His office subsequently advised us that, as a consequence of our hearing, communications, training and coordination have improved significantly in Southern California. Several other U.S. Attorneys surveyed by the subcommittee confirmed the lack of such coordination in their districts. The U.S. Attorney in Chicago has formed a Banking Regulators Forum, made up of representatives from Federal and State banking agencies and also several law enforcement agencies, which meets every 6 to 8 weeks, and has been reportedly very successful in carrying out joint efforts and communicating instances of misconduct.

a. Does the FDIC support the formal creation of such task forces or groups, particularly in those districts with large numbers of cases or where there have been problems in the past? If not, why not? If so, has the agency considered taking steps to work with other agencies, to create them? Which agency should serve as the lead agency in this effort or should it be a joint effort?

b. Irrespective of the creation of such interagency groups, what steps is the FDIC prepared to take to foster improved coordination and communication at the local level, particularly between the FBI/U.S. Attorneys offices and your agency's examination and supervision staff?

D.1, 2(a), 2(b).Answers:

The Bank Fraud Enforcement Working Group is functioning very effectively at the headquarters level. However, any real progress in overcoming bureaucratic inertia and other obstacles to effective cooperation must be made at the local level, where information in one form or another is critical to the success of specific investigations and prosecutions. We have always supported the formation of local interagency groups, both formal and informal, to deal with criminal activity. In fact, we were initially skeptical of a Washington level concept such as the Bank Fraud Working Group fearing that its scope would not reach far enough into each participating organization to be effective. We have been pleased, however, with the commitment demonstrated by the Justice Department's Criminal Division and believe that this commitment is evident in the accomplishments of the Working Group. We are also pleased with the efforts of many U.S. Attorneys to carry this commitment to local areas. Unquestionably, local forums such as the one established in Chicago represent an effective solution to problems relating to coordination and cooperation. We would like to see these forums established in all districts. In our view, local forums are effective for several reasons. First, if organized by the U.S. Attorney, they demonstrate the U.S. Attorney's commitment to prosecuting bank fraud cases. Second, examiners get feedback on the results of recent cases and are directly informed of any changes in investigative or prosecutive policies. And third, crimes affecting banks that are outside the FBI's jurisdiction, such as money laundering, can also be discussed at the meetings, bringing in the views of other investigative agencies, such as Customs, IRS, and the Secret Service.

The FDIC has, for several years now, encouraged its field office supervisors to initiate contacts with FBI agents in their local areas. Names and phone numbers of field office supervisors are provided to the FBI periodically. We have initiated dialogue with law enforcement officials in all of our regional locations and, in some cases (Atlanta and Kansas City, for example), the FDIC has taken the lead in organizing interagency meetings. As we stated earlier, the FDIC encourages frequent contact with law enforcement officials at all levels; however, we believe the U.S. Attorney is in the best position to coordinate resources in local jurisdictions.

D.3.Question:

Based on all of the bank regulatory agencies recent submissions to the subcommittee, it appears that lists of persons suspected of and financial institutions affected by alleged criminal misconduct (and the outcome of any investigations) are not systematically shared or received among the agencies. Since the FBI's FOIM System will not be fully operational for at least one year, what are your views on developing a policy whereby at least all significant referral information (names and institutions) would be automatically (a) shared by each agency with all other banking agencies and (b) entered into every agency's computer system, to track individuals who move among different kinds of financial institutions?

D.3.Answer:

Managing all the information generated to deal with individual fraud and insider abuse presents a real challenge. The information originates from thousands of financial institutions, a half-dozen regulatory agencies, the

FBI, Secret Service and Justice Department, not to mention state regulators and prosecutors. FOIMS, the FBI's Field Office Management System, represents the most efficient system for collecting and disseminating the information needed for regulatory and law enforcement purposes. In the time remaining before FOIMS becomes fully operational, the regulatory agencies have agreed to exchange lists of significant criminal referrals at the Washington level and to exchange actual copies of criminal referrals at the regional level. We believe this type of information exchange will minimize the risks without causing the establishment of redundant computer systems.

IMPROVEMENTS IN EXCHANGES OF INFORMATION

E.1.Question:

1. Mr. Jeffrey Jamar, chief of the FBI's white collar crime section, testified at the subcommittee's June 13th hearing, as follows: "It is preferable for appropriate banking agencies to refer any criminal misconduct uncovered while examinations are still underway rather than waiting until the institution is actually closed (or afterwards). This facilitates the investigative process by allowing FBI agents to interview examiners and/or institution employees while they are still available and while the records are still accessible and available for review by both the examiner and the FBI agents...." Several U.S. Attorneys have made similar recommendations, strongly urging that FBI agents be brought into the institution at the time of failure, if not before. Questions: Please respond to this recommendation. Should the bank regulatory agencies consider changing their policies so that FBI agents can be present prior to, at the time of, or immediately after an

institution's closing, if abusive practices or criminal activities are suspected? Is the FDIC prepared to take steps to seek a change in policy and procedures?

E.1.Answer:

Communication between the FDIC and the FBI prior, during and after a bank fails has never been better. While we do not notify the FBI of the time and place of all bank failures, it is our practice to keep them informed of the pending failure of banks in which criminal conduct has been identified or is strongly suspected. In many of these cases, FBI agents are invited along to the bank on the day it closes. Through the network of contacts established by the Bank Fraud Working Group, and as a result of local meetings such as the Chicago forum, examiners, liquidators and federal investigators are prepared well in advance of a bank failure to deal with the consequences of criminal conduct during and after the bank fails.

If FDIC examiners have identified possible fraud and abuse in a failing bank a criminal referral will be made prior to the failure. In these cases, it is our practice to work closely with the FBI before, during and after the closing. In other cases, where criminal wrongdoing was not identified or suspected prior to the failure but was discovered after FDIC liquidators had an opportunity to review the records of the failed bank, the FBI would be notified after the bank closed. In either case, communication channels have been established between liquidators and FBI agents to enable information about suspicious activity or potential criminal misconduct to be passed in both directions.

E.2.Question:

U.S. Attorneys, the Fraud Section, and the FBI have encountered problems interviewing examiners and work papers. In its 7/9/87 submission to the subcommittee, the Criminal Division states that, while it is often necessary for FBI agents and prosecutors to interview the agency examiners whose work product was crucial to relevant examination reports, "by that time the examiners are examining a bank or thrift in yet another city. Their schedules and memoranda are in storage in another city. Therefore, it is not easy to bring the agents, the examiners and their work product together." (One U.S. Attorney had to send an assistant to travel to other regions of the country because of this problem.) In his 6/13/87 testimony, FBI official Jamar stated: "Easier access to both examination reports and the examiner most knowledgeable in the area of the reports would be of great assistance, [particularly in cities] where neither the FDIC nor the FSLIC maintain offices." Part of the problem arises, because, as U.S. Attorney Robert Bonner testified (subcommittee's 6/13/87 hearing), banking agency examiners do not follow-up on referrals which they do make and do not provide copies of key documents and interview memoranda of key witnesses at an early stage, preferably close to the time of the examination. Question: How can this problem be resolved? What steps is the FDIC prepared to take to overcome the problems cited?

E.2.Answer:

It is FDIC's policy (and the policy extends to outside counsel) to promptly refer apparent criminal activity to appropriate law enforcement officials. We are committed to providing the assistance and expertise of FDIC examiners wherever and whenever they are needed to improve the prospects of a bank fraud prosecution. Logistical problems in gathering evidence and staging interviews are inevitable given the requirements of a bank examiner's job. Nonetheless, these problems are being minimized as prosecutors and FBI Agents become more familiar with the examination process. Through periodic meetings between bank regulators and law enforcement officials and formal and informal channels of communication, the bank fraud threat in each district can be better understood.

E.3.Question:

(a) Please discuss any recent typical problems which the FDIC has had with both the Right to Financial Privacy Act and with obtaining information under Rule 6(e). (b) What specific changes do you recommend in the Act? (c) Over the years this subcommittee has heard (and been sympathetic to) complaints about the RFPA from the bank regulatory agencies and the Justice Department, which have urged the Congress to change the statute. What specific efforts has the FDIC made, to attempt to convince both the House and Senate Banking Committees of the need to do so?

E.3.Answer:

The flow of information that is critical to effective prosecutions and to informal bank supervision is circumscribed by the Right to Financial Privacy Act (RFPA) and Rule 6(e). In a sense, the Rule 6(e) problem was exacerbated by the RFPA. Both problems can be lessened considerably by eliminating RFPA restrictions covering transfers of information from bank regulators to law enforcement authorities and vice versa.

If FDIC were free from the RFPA customer notice requirements -- which Justice wants to avoid in criminal cases -- information acquired for supervisory purposes could be transferred and fully explained without causing the U.S. Attorney to issue a grand jury subpoena. Thus, the preliminary information provided would not be subject to Rule 6(e). Should the Congress enact the amendments recommended by the Bank Fraud Working Group and included in the regulators' legislative package, U.S. Attorneys could gather evidence from banks or from regulators prior to convening a grand jury. Material obtained this way would remain outside the ambit of Rule 6(e) and, if appropriate, could be lawfully provided to bank regulators for legitimate regulatory purposes.

Probably the most adverse impact of the RFPA on our cooperative efforts is the chilling effect or psychological impediment the Act exerts on the relations and interactions of examiners and law enforcement agents. We will never know how many cases were jeopardized by this chilling effect. Nevertheless, the public interest can be seriously harmed by closing off the flow of critical information between federal agencies.

To illustrate, because of the RFPA, and to some extent Rule 6(e) restrictions, the FBI is prohibited from informing FDIC liquidators of information its agents learn from closed bank investigations. We know of one instance involving millions of dollars, the whereabouts of which was learned by the FBI in its criminal investigation. Because of legal restrictions, however, this crucial information could not be passed on to the FDIC, removing the opportunity to restore millions of dollars to the FDIC insurance fund.

Amending the RFPA as recommended by the Bank Fraud Working Group would give Justice greater latitude to investigate and collect evidence before convening a grand jury. Under the amendments, information gathered this way could be exchanged with the banking agencies for regulatory purposes and with the FDIC for receivership purposes.

E.4.Question:

Other than amendments to Rule 6(e), what recommendations, if any, would you make to improve the exchange of information from Federal law enforcement agencies to the bank regulatory agencies?

E.4.Answer:

We strongly recommend amending the RFPA as proposed by the Bank Fraud Working Group and the financial institution regulators.

E.5.Question:

Mr. Jamar also testified, "The FBI's experience is that in some failures, fee counsel have not made timely and adequate referrals while in other instances they have not." The FDIC's 10/30/87 letter to the subcommittee pointed out some reasons why fee counsel are reluctant to make criminal referrals, but indicated that it is considering providing guidance to fee counsel. What directive is the FDIC prepared to send to all fee counsel requiring timely criminal referrals? (The FDIC's Guide for Legal Representation which governs the activities of outside counsel does not provide clear guidance on this issue to fee counsel.)

E.5.Answers:

Copies of the directives are attached.

SUFFICENCY AND ALLOCATION OF PROSECUTIONAL RESOURCES AND EVALUATION OF PROSECUTORIAL DECLINATIONS OF SUFFICANT REFERRALS

F.1.Question:

(a) Based on the experience of FDIC regional officials, please identify those FBI divisions where long investigative delays have occurred and which probably have lacked sufficient manpower resources? (b) Please describe any efforts taken to remedy this lack of resources, including meetings at the local level or at headquarters, and indicate the outcome.

F.1.Answers:

(a) The majority of the FDIC Regional Offices report no long investigative delays at FBI divisions within their areas. The Chicago Regional Office reported some delays in investigations in Wisconsin and the Columbus Regional Office reported some investigative delays in Eastern Kentucky that may be attributed to manpower shortages. The San Francisco Regional Office reported some past investigative delays in Los Angeles and Orange County, California, but indicated that the situation is improving, particularly in cases involving $100,000 or more in estimated losses.

F.2.Question:

Similarly, which U.S. Attorneys' Offices have backlogs in prosecuting bank fraud and embezzlement cases arising out of open State nonmember banks of failed FDIC-insured banks? Please identify the U.S. Attorneys' Offices involved and quantify the problem. (Give a representative example of a matter long delayed, without naming suspects.)

F.2.Answer:

The FDIC's Columbus Regional Office reported one case involving about $3.5 million in losses which has been pending since February, 1983 in the Eastern District of Kentucky. The delay appears to be due to limited manpower resources; however, trial has been scheduled for early in 1988. The FDIC's Memphis Regional Office reported some prosecutive delays in the Eastern District of Tennessee and in some parts of Louisiana. The delays appear to be due to manpower shortages and heavy case loads. One case in the Eastern District of Tennessee involves approximately $12 million in estimated losses and has been pending since 1984. It should be noted that it is not always possible for the FDIC to determine whether delays are attributable to delays in investigations or delays in prosecution. In many cases, we are not informed when an investigation is completed and turned over to the prosecutors.

F.3.Question:

U.S. Attorneys' Offices have declined 16 referrals designated as significant by the FDIC (Attached are summaries provided by the Criminal Division). (a) In each case, was the FDIC satisfied with the prosecutorial decision? If not, identify the case (by summary sheet) and describe the efforts made to have the matter reconsidered? (b) Did the FDIC take any civil enforcement actions against any of the individuals against whom a prosecution was declined? Reference each summary page and indicate any civil enforcement action taken.

F.3.Answer:

(a) The FDIC Regional Offices indicated some dissatisfaction with the prosecutorial decisions involving control numbers 8600753, 8600276 and 8700705. We were advised that briefings on all three cases were being sought by regional officials either at an interagency session or by some other means, probably over the telephone.

(b) Civil actions have been taken against some of the individuals identified in the declinations. The individual involved in case control number 8600753 was the subject of a Section 8(e) removal order on July 22, 1986. The individual involved in case control number 8700705 was the subject of a removal settlement agreement dated August 19, 1983. Some cases involved outside borrowers or other bank customers which are not subject to FDIC's civil enforcement authority.

G.Question:

The OCC, FRB, the FDIC, and the NCUA have been considering a legislative package to increase the agencies' civil enforcement authority, such as allowing the agencies to proceed against individuals who have resigned from a financial institutions and to issue industrywide prohibition orders. (Some of the provisions are similar to those in the proposed Depository Institutions Insider Fraud Prevention Act of 1986 (99th Congress). Please indicate the status of that legislative proposal, and, if possible, provide a copy.

G.Answer:

The financial institution agencies' joint enforcement proposal recently has been completed and is being prepared for submission to the appropriate

Congressional committees for their consideration. We anticipate that a copy of the proposal will be delivered to you by the time our testimony is presented.

The proposal would amend the enforcement statutes to improve the agencies' ability to combat insider abuse, misconduct and fraud at our nation's depository institutions. Examples of changes included in the proposal are amendments (1) to clarify that the agencies may require affirmative action in cease and desist orders to correct the conditions which resulted from unsafe or unsound banking practices, (2) to specifically allow the agencies to place limitations on the activities of an individual at a bank without having to completely remove the individual from banking, and (3) to make certain that termination of employment or other separation from an insured bank by a bank-related person does not affect the agency's authority to bring removal actions against that person for improper conduct.

Guidelines for Financial Institution Directors

A financial institution's board of directors oversees the conduct of the institution's business. The board of directors should:

- select competent management;
- establish with management the institution's long and short term business objectives and adopt operating policies designed to achieve these objectives in a manner consistent with law and safe and sound practices;
- monitor operations to ensure they are controlled adequately and are in compliance with laws and policies;
- oversee the institution's business performance; and
- ensure the institution helps to meet its community's credit needs.

These responsibilities are governed by a complex framework of federal and state law and regulation. These guidelines do not modify the legal framework in any way and are not intended to cover every conceivable situation that may confront an insured institution. Rather, they are intended only to offer general assistance to directors in meeting their responsibilities. Underlying these guidelines is the assumption that directors are making an honest effort to comply with all applicable laws, regulations, and safe and sound practices.

In meeting the board s responsibilities, the board and its members should:

1. Maintain the independence of the board of directors. Effective corporate governance requires a high level of cooperation between an institution's board and its management. Nevertheless, a director's duty to oversee the conduct of the institution's business necessitates that each director exercise independent judgment in evaluating management's actions and competence. Critical evaluation of issues before the board is essential. Directors who routinely approve management decisions without exercising their own informed judgment are not serving their institutions, their stockholders, or their communities adequately.

2. Keep informed. Directors must keep themselves informed of the activities and condition of their institution and of the environment in which it operates. They should attend board and any assigned committee meetings regularly and should be careful to review closely all meeting materials, auditor's findings and recommendations, and supervisory communications. Directors also should stay abreast of general industry trends and any statutory and regulatory developments pertinent to their institution's operations. Directors should work with management to develop a

program to keep members informed. Periodic briefings by management, counsel, auditors or other consultants might be helpful and more formal director education seminars should be considered.

The pace of change in the nature of the business of financial institutions today makes it particularly important that directors commit adequate time in order to be informed participants in the affairs of their institution.

3. Act to ensure qualified management. The board of directors is responsible for ensuring that the day-to-day operations of their institution are in the hands of qualified management. If the board becomes dissatisfied with the performance of the chief executive officer or senior management, it should address the matter directly. If hiring a new chief executive officer is necessary, the board should act quickly to find a qualified replacement. Ability, integrity, and experience are the most important qualifications for a chief executive officer.

4. Supervise management adequately. Supervision is the broadest of the board's duties and the most difficult to describe, as its scope varies according to the facts and circumstances of each case. Consequently, the following suggestions should be viewed as general.

   a. Establish Policies. The board of directors should ensure that all significant activities are covered by written policies that are clearly communicated so that the policies can be readily understood by affected parties, including all employees. All policies should be monitored to ensure that they conform with changes in laws and regulations, economic conditions, and the institution's circumstances. Specific policies should cover at a minimum:

   - loans, including internal loan review procedures
   - investments
   - asset-liability/funds management
   - profit planning and budget
   - capital planning
   - internal controls
   - compliance activities
   - audit program
   - conflicts of interest
   - code of ethics

   These policies should be formulated to further the institution's business plan in a manner consistent with safe and sound practices. They should contain procedures, including a system of internal controls, designed to foster sound practices, to comply with relevant laws and regulations, and to protect the institution against external crimes and internal fraud and abuse.

b. Monitor implementation. The board's policies should establish mechanisms for providing the board the information needed to monitor the institution's operations. In most cases, these mechanisms will include management reports to the board. These reports should be carefully framed to present information in a form meaningful to the board. The appropriate level of detail and frequency of individual reports will vary with the circumstances of each institution. Reports generally will include information such as the following:

- the income and expenses of the institution
- capital outlays and adequacy
- loans and investments made
- past due and negotiated loans and investments
- problem loans, their present status and workout programs
- allowance for possible loan loss
- concentrations of credit
- losses and recoveries on sales, collection, or other dispositions of assets
- funding activities and the management of interest rate risk
- performance in all of the above areas compared to past performance as well as to peer groups' performance
- all insider transactions benefiting directly or indirectly controlling shareholders, directors, officers, employees, or their related interests
- activities undertaken to ensure compliance with applicable laws (including among others, lending limits, consumer requirements, and the Bank Secrecy Act) and any significant compliance problems
- any extraordinary development likely to impact the integrity, safety, or profitability of the institution

Reports should be provided far enough in advance of board meetings to allow for meaningful review. Management should be asked to respond to any questions raised by the reports.

Experience has shown that certain aspects of the lending function are responsible for a great number of the problems experienced by troubled institutions. The importance of policies and reports which reflect on loan documentation, performance, and review cannot be overstated.

c. Provide for independent reviews. The board also should establish a mechanism for independent third party review and testing of compliance with its policies and procedures and applicable laws and regulations, and of the accuracy of the information provided by management. This might be accomplished by an internal auditor reporting directly to the board, or by an examining committee of the board itself. In addition, a comprehensive annual audit by a CPA is desirable. It is highly recommended that such an audit include a review of asset quality. The board should review the auditors' findings with management and should monitor management's efforts to resolve any identified problems.

In order to discharge their general oversight responsibilities, the board or its audit committee should have direct responsibilities for hiring, firing, and evaluating the institution's auditors, and the board should have access to the institution's regular corporate counsel and the institution's staff as required. In some situations, outside directors may wish to consider employing their own outside counsel, accountants or other experts, at the institution's expense, to advise them on special problems arising in the exercise of their oversight function. Such situations might include the need to develop appropriate responses to identified problems in certain important areas of the institution's performance or operations.

d. Heed supervisory reports. Board members should personally review any reports of examination or other supervisory activity and any other correspondence from the institution's supervisors. Any findings and recommendations should be reviewed carefully, and progress in addressing identified problems should be tracked. Directors should discuss issues of concern with the examiners.

5. Avoid all preferential transactions involving insiders or their related interests. Financial transactions with insiders must be beyond reproach. They must be in full compliance with laws and regulations concerning such transactions, and be judged as objectively as transactions with unrelated customers. The basis for that judgment must be fully documented. Directors and officers who permit preferential treatment of insiders breach their responsibilities, expose themselves to serious civil and criminal liability, and may expose their institution to a greater than ordinary risk of loss.

Knowledgeable and effective directors are an integral part of a safe and sound banking system. These guidelines are intended to assist financial institution directors in understanding and fulfilling their duties.

A more detailed discussion of a director's role and responsibilities is available in the Office of the Comptroller of the Currency's new book, The Director's Book - The Role of a National Bank Director. It is available from the Communications Division, Office of the Comptroller of the Currency, Washington, D. C. 20219.

MEMORANDUM TO: FEE COUNSEL

FROM:

SUBJECT: Possession of Information Regarding Possible Criminal Misconduct

The FDIC has a longstanding responsibility and policy of promptly notifying and, where appropriate, assisting law enforcement officials in investigating conduct which may constitute a violation of the criminal statutes.

From time to time the FDIC's outside counsel may obtain information pursuant to civil litigation which may indicate possible criminal behavior. If this is ever the case, outside counsel must immediately notify the FDIC attorney who is monitoring the case or any other member of the FDIC Legal Division. Unless directed to do so by a member of the Legal Division, outside counsel should not deal directly with the criminal authorities. This is only because of the unique position of the FDIC which makes it subject to certain federal laws and other procedures. Under no circumstances, however, are outside counsel to delay informing FDIC counsel of possible criminal conduct.

CAB/jem
008

MEMORANDUM TO: FDIC Counsel

FROM:

SUBJECT: Referral of Possible Criminal Misconduct For Prosecution

Attached is a memorandum to outside counsel describing the longstanding policy of the FDIC of promptly notifying the appropriate authorities of possible criminal behavior. Outside counsel have a responsibility to immediately notify the Legal Division when they become aware of possible criminal activity so the FDIC may fulfill its responsibilities in this regard. This memorandum establishes a procedure for the Legal Division to follow each time an FDIC attorney becomes aware of possible criminal activity whether that information is transmitted by outside counsel or if it comes to your attention by any other source.

Attached is a criminal referral form which has been developed to accommodate such concerns as the Right to Financial Privacy Act and the attorney-client privilege. When you receive notice of potential criminal activity, you must fill out the form, or cause it to be filled out, and send it to the appropriate criminal authorities as soon as possible. A copy of the form must always be sent to the Senior Attorney, Regional Affairs Section in Washington, D.C.

CAB/jem
009

REPORT OF APPARENT CRIME
(DOL)

Federal Deposit Insurance Corporation - Division of Liquidation

ATTENTION:
Use this form in all cases where suspected criminal activity involves probable loss (before reimbursement or recovery) of $10,000 or greater and in all cases, regardless of amount, involving an executive officer, director or principal shareholder of the institution within the meaning of 12 C.F.R. §215 (with the term "member bank" deemed to mean all federally insured banks.) This form should be promptly filed by the investigator following discovery of the suspected violation.

The purpose of this form is to provide a consistent means by which the FDIC's Division of Liquidation can make referrals of known or suspected criminal activity perpetrated against the institutions whether by insiders or those outside the institution. The form will provide an effective means by which appropriate law enforcement and supervisory authorities will be made aware of known or suspected criminal activity. Investigators should use care in filling out this form and should insure that it is filled out in as complete a manner as practicable under the circumstances.

1. Name and Location of Financial Institution — 1a. Date this Institution was closed: ___/___/___.

NAME ______________________________

LOCATION ______________________________
STREET CITY ST ZIP

CERTIFICATE NUMBER ____________ If activity occurred at branch office(s), please identify: ______________________________

2. Asset Size of Financial Institution When Closed *(millions of dollars)* ____________

3. Approximate date and dollar amount (prior to any allowance for restitution or recovery) of suspected violation.

Date ____________ AMOUNT (thousands of dollars) $ ____________
MONTH DAY YEAR

4. Summary characterization of the suspected violation. Check appropriate box(es)

- ☐ Defalcation/Embezzlement
- ☐ False Statement
- ☐ Check Kiting
- ☐ Bribery/Gratuity
- ☐ Misuse of Position or Self-Dealing
- ☐ Mysterious Disappearance
- ☐ Other (Describe) ______________________________

Applicable Section(s) of the U.S. Code (if known). (See list on page 7) ______________________________

5. This matter is being referred to the FBI in ______________________________
CITY ST

and the U.S. Attorney in ______________________________ ______________________________
CITY ST JUDICIAL DISTRICT *(if known)*

MEMORANDUM TO: FEE COUNSEL

FROM:

SUBJECT: Possession of Information Regarding Possible Criminal Misconduct

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CAB/jem
008

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(DOL)

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1a. Date this Institution was closed: ___/___/___.

NAME ______________________________

LOCATION ______________________________
STREET CITY ST ZIP

CERTIFICATE NUMBER ____________ If activity occurred at branch office(s), please identify: ______________________________

2. Asset Size of Financial Institution When Closed *(millions of dollars)* ____________

3. Approximate date and dollar amount (prior to any allowance for restitution or recovery) of suspected violation.

Date ____________ AMOUNT (thousands of dollars) $ ____________
MONTH DAY YEAR

4. Summary characterization of the suspected violation. Check appropriate box(es)

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- ☐ False Statement
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- ☐ Misuse of Position or Self-Dealing
- ☐ Mysterious Disappearance
- ☐ Other (Describe) ____________

Applicable Section(s) of the U.S. Code (if known). (See list on page 7) ____________

5. This matter is being referred to the FBI in ______________________________
CITY ST

and the U.S. Attorney in ____________ ____________
CITY ST JUDICIAL DISTRICT *(if known)*